

State of Indiana
Drinking Water State Revolving Fund
Intended Use Plan
SFY 2004

I. Introduction

Pursuant to the Safe Drinking Water Act ("SDWA"), the State of Indiana ("State"), acting through its Department of Environmental Management ("Department" or "IDEM") and the State Budget Agency ("Budget Agency"), hereby submits to the United States Environmental Protection Agency ("EPA") and the public this Intended Use Plan ("IUP") for State Fiscal Year ("SFY") 2004 for its Drinking Water State Revolving Fund ("DWSRF"). This IUP will also support the State's upcoming grant application to obtain additional capitalization grant awards, which is presently an estimated \$9 million for Federal Fiscal Year ("FFY") 2004 funding. The State believes that with the award of the SFY 2004 grant to continue capitalizing the DWSRF, demand for assistance will be met during SFY 2004. DWSRF assistance will be managed as noted in Section VII captioned "*Projects to be Assisted*" below.

The purpose of the DWSRF Program is to assist public water systems by financing their needed drinking water infrastructure projects, supporting programs to improve the capability of small drinking water systems, and protecting sources of drinking water throughout the State. The DWSRF Program is administered jointly by the Department and the Budget Agency. The Department is responsible for setting priorities for loan assistance from the DWSRF, which is evidenced by a Project Priority List ("PPL").

An IUP is prepared each year to identify the uses of all monies available to the DWSRF. Each IUP includes the following:

- A description of the financial status of the DWSRF and the short-term and long-term goals of the Program;
- The criteria and methods established for the distribution of funds; and
- A list of projects to be assisted in the SFY following adoption of the IUP, including a description of the projects, the amount of financial assistance requested and the size of the community served.

II. Definitions

Terms used in this document have the following respective meanings ascribed to them:

Applicant means any owner of a Public Water System, either publicly- or privately-owned, applying for a DWSRF Loan.

Bypass Process means, consistent with 40 CFR § 35.3555(b)(2)(ii), the procedures which would allow the State to bypass projects identified in a Fundable Range if the Budget Agency determines during the SFY that there may be insufficient resources to fund all loans on the PPL. If applicable, this allows

other projects on the Comprehensive Project Priority List that are ready to proceed to receive financial assistance from the DWSRF during SFY 2004 when bypassed projects (as originally identified in the Fundable Range, should that be determined) have not progressed to a stage allowing for funding

Capitalization Grant means a grant, as evidenced by an agreement with EPA, that provides funds to capitalize the DWSRF.

Comprehensive Project Priority List means the all-inclusive list of scored and ranked projects seeking funding and expected to be eligible under the DWSRF Program for the upcoming program year.

Drinking Water Program or **Drinking Water Branch** means the branch of the Department whose priority is to operate programs to fulfill the requirements of the Safe Drinking Water Act.

DWSRF means the State's Drinking Water State Revolving Fund pursuant to the Safe Drinking Water Act and State law.

DWSRF Program means the Drinking Water State Revolving Fund Program -- a low interest loan program available to eligible Participants.

EIWG means Environmental Infrastructure Working Group. EIWG meets once a month and is organized by Indiana Rural Development.

Fiscal Year (FY) means the fiscal year for the year indicated. **FFY** means the Federal Fiscal Year beginning October 1st and ending September 30th; **SFY** means the State Fiscal Year beginning July 1st and ending June 30th.

Fundable Range means an assumed amount of DWSRF loans that could be made under various assumptions using current loan capacity estimates and, with respect to which, projects on the PPL are expected to receive assistance from the available funds subject to the DWSRF's Bypass Process.

Guarantee Revenue Bonds means one or more series of revenue bonds issued from time to time by the State Issuer to fund the DWSRF Program. Federal capitalization grants provide security for, and the DWSRF is the source of revenue for, the payment of Guarantee Revenue Bonds. Guarantee Revenue Bond net proceeds are loaned to Participants to finance Proposed Drinking Water Projects.

Participant(s) mean(s) public water systems that are eligible for financial assistance from the DWSRF including nonprofit and for-profit entities and Political Subdivisions.

Political Subdivision means a municipal corporation, special taxing district (sanitary/conservancy district), a regional water, sewer, or waste district, or any other separate local governmental entity.

Preliminary Engineering Report (PER) means the document submitted by the Applicant that provides the information necessary for the Department to determine the technical, economic, and environmental adequacy of the proposed drinking water project.

Preplanning Meeting means a meeting held with the “Participant” (including community officials and their engineering consultant) after SRF receives the application to further explain SRF requirements and the process involved in closing a loan.

Project Priority List or **PPL** means the list of eligible applicants, which are scored and ranked based on the priority of needs, prepared pursuant to Section 1452 of the Safe Drinking Water Act. See *Appendix B*.

Proposed Drinking Water Projects means the drinking water infrastructure projects proposed by Applicants for SRF financing in SFY 2004, which will be reviewed for qualification and ranking under Section 1452 of the Safe Drinking Water Act.

Public Water System is a system that supplies piped water for human consumption and has at least 15 service connections or 25 persons who are served by the system for 60 or more days each year.

Safe Drinking Water Act or **SDWA** means the Safe Drinking Water Act of 1974, as amended, Section 1452, and the rules and regulations promulgated thereunder including 40 CFR Part 35.

Scoring and Ranking System means the Priority Ranking System, a system by which the Department evaluates and ranks proposed drinking water infrastructure projects for listing on the Priority List. See *Appendix A*.

Set Asides means the non-project activities that are not directly associated with the construction of capital improvement projects but are allowed uses of DWSRF Capitalization Grant monies specifically identified in Section 1452 of the SDWA.

State Issuer means the Indiana Bond Bank or other permitted State-level issuers of Guarantee Revenue Bonds and State Match Revenue Bonds.

State Law means Indiana Code 13-18-21 *et seq.* and the State Drinking Water SRF rules and regulations promulgated thereunder.

State Match means the State's commitment to provide matching funds equal to 20 percent of each Capitalization Grant for the DWSRF.

State Match Revenue Bonds means one or more series of revenue bonds issued by the State Issuer as needed to fund the State Match.

Wastewater SRF and Wastewater SRF Program means the State's wastewater revolving loan fund established under and pursuant to I.C. 13-18-13 and the programs afforded thereby.

III. Project Priority List

The Project Priority List for SFY 2004 is attached as *Appendix B*. The Priority List includes all Proposed Drinking Water Projects.

IV. Project Ranking

In determining which Proposed Drinking Water Projects will receive loans, the State expects to follow criteria for assistance established by the SDWA. To the extent practical, the State expects to give priority to projects that propose the following:

- Address the most serious risk to human health;
- Are necessary to ensure compliance with the SDWA; and
- Assist systems most in financial need on a per household basis according to state affordability criteria.

The Scoring and Ranking System designed to implement the SDWA criteria is attached as *Appendix A*. The DWSRF Program focuses on expediently moving towards loan closure those projects on the PPL that have higher priority health concerns. Ranking is an important component of the program particularly if during SFY 2004 the Budget Agency were to determine that available funds were insufficient to fund all projects on the Comprehensive Project Priority List. In that case, the Fundable Range and Bypass Process procedures would be implemented. The DWSRF assistance is managed within the lending capacity limits of the DWSRF and is addressed in more detail in Section VII below, captioned "*Projects to be Assisted*."

V. Intended Use Plan

A. Goals and Objectives

The goal of the DWSRF is to assure safe drinking water to Indiana's water consumers by prioritizing funding of Proposed Drinking Water projects that provide greater protection of public health or ensure SDWA compliance, as well as assisting water systems most in need on a per household basis. For purposes of this Intended Use Plan, short-term goals and objectives are those that the State expects to achieve this coming SFY, while long-term goals and objectives are those that the State does not expect to achieve fully in this SFY.

1. Short-Term Goals and Objectives

During SFY 2004, the Department and the Budget Agency expect to work towards achieving the following short-term goals and objectives:

(ST1) Integrate highly coordinated management within the DWSRF Program through the newly created and staffed SRF Program Executive Director position.

(ST2) Integrate and coordinate relationships among the State agencies involved with the DWSRF Program so that the DWSRF Program operates seamlessly and Participants are benefited by more effective and efficient services.

(ST3) Once additional federal funding becomes available (which is expected by October 1, 2003), seek the immediate award of the Capitalization Grant for the FFY 2004. The State expects that all the federal Capitalization Grants, through and including that related to FFY 2004, related to loan assistance will be converted to cash and deposited in the DWSRF in SFY 2004 through

disbursement of loan proceeds. The State expects that all the federal Capitalization Grants, through and including that related to FFY 2004 and related to set-aside and administrative activities will be converted to cash as expenditures are incurred or paid.

(ST4) Encourage EPA to effectuate changes in the Safe Drinking Water Act to permit transfers between the Wastewater SRF and the DWSRF. In the event it is extended, the State will review and determine the amount of transfers to be made from the Wastewater SRF to the DWSRF. Such transfer would be made to the extent necessary to continue meeting the immediate financing needs of the Drinking Water SRF but only to the extent that it is determined that they would not materially prevent the ability of the Wastewater SRF to meet the financing needs of the proposed projects for SFY 2004. Upon such determination, the Budget Agency would implement such transfers. (Absent a change in the Safe Drinking Water Act, the State cannot make further transfers in SFY 2004.)

(ST5) Continue focusing the DWSRF Program on providing financial assistance to Proposed Drinking Water Projects based on public health needs. During the SFY, the Budget Agency will continue to monitor whether demand for DWSRF assistance can be fully met. If during SFY 2004 the Budget Agency were to determine that funds available were insufficient to fund all projects on the Comprehensive Project Priority List, then the Fundable Range and the Bypass Process procedure would be implemented. If there are insufficient funds to fund all projects on the Comprehensive Project Priority List Projects prior to January 1, 2004, then only Proposed Drinking Water Projects ranked within the Fundable Range would be permitted to complete their DWSRF financial assistance. After December 31, 2003, the program will ensure progress is made by also considering "readiness-to-proceed" under the Bypass Process. (See the Section VII. captioned "*B. Fundable Range*" and "*C. Bypass Process*" below.)

(ST6) Work diligently with Participants and effectively manage Proposed Drinking Water Projects to assist Participants in closing on their loan and constructing their project in a timely, efficient manner

(ST7) Continue working with the various drinking water infrastructure-financing agencies/departments through EIWG to coordinate the financing of drinking water infrastructure in the most beneficial way for Participants, while continuing to meet the needs and requirements of each financial assistance program.

(ST8) Continue providing all DWSRF Applicants with a boilerplate Preliminary Engineering Report (PER) on disk following their Preplanning Meeting on the expectation that having the PER in disk format will allow Applicants to produce and submit a PER in a more timely manner.

(ST9) More strictly enforce the PER submittal policy of 120 days post Preplanning Meeting to ensure IDEM receives the PER in a timely manner.

(ST10) Monitor the review time of PERs at IDEM, follow projects from cradle to grave, and evaluate the use of staff resources.

(ST11) Continuously update post-loan origination management manual and implement activities related to the same.

(ST12) Update as necessary the administrative, technical, and environmental standard operating procedures' manuals.

(ST13) Absent prior arrangements having been made, continue to encourage Participants to draw down on their loans or terminate their ability to do so within a year after substantial completion of construction.

(ST14) Establish protocol on the management of confidential documents regarding security of drinking water systems.

(ST15) Formalize an inspection program that documents the progress of DWSRF projects, including the construction phase and the post construction or substantial completion phase.

(ST16) Establish measurable criteria to evaluate the success of Indiana's DWSRF Program in terms of providing safe drinking water to Indiana residents and within the context of watershed quality.

(ST17) Produce an Indiana DWSRF report for public distribution containing EPA's annual report requirements, descriptions of SRF activities, a list of communities involved in the DWSRF Program, and photos of completed projects. The finished product will be utilized to further market the DWSRF Program and provide information about our program and its successes to potential applicants.

2. Long-Term Goals and Objectives

The primary goal of the DWSRF Program is to ensure safe drinking water by addressing the most serious threats to public health, facilitating compliance with the SDWA, and promoting affordability. This primary goal is supported by the following long-term objectives:

(LT1) Provide financial assistance to Participants to help them comply with federal and State drinking water standards. It is the State's policy to satisfy as many drinking water infrastructure needs as possible by providing low-cost financing, commensurate with prudent fiscal and credit standards.

(LT2) Secure Indiana's full share of federal funds made available in the annual federal budget and expeditiously obligate these funds for publicly- and privately owned drinking water infrastructure and source water protection projects.

(LT3) Achieve 100% response rate and provide quality assurance on the Drinking Water Infrastructure Needs Survey, which represents the twenty-year projected needs for drinking water infrastructure improvements within the State in order to increase the State's percentage of the available federal appropriation.

(LT4) Maintain the financial integrity of the DWSRF over time by judiciously using its assets and realizing an adequate rate of return to sustain the SRF in perpetuity.

(LT5) Support activities in the Drinking Water Program (i.e., operating a Source Water Assessment Program and Small System Technical Assistance).

(LT6) Continue to provide small systems (population <10,000) with financial assistance for water system improvements, in accordance with the SDWA.

(LT7) Ensure that new and presently operating public water systems have the capacity to produce water safe in quality and adequate in quantity, including the 1996 SDWA provisions for Capacity Development and Operator Certification.

(LT8) Provide financial assistance to protect the State's ground and surface water drinking water sources.

(LT9) Continue providing a point of contact for Participants to call for updates on the review status of their Proposed Drinking Water Projects.

(LT10) Assist in achieving the objective as stated in the 1997-1998 Environmental Performance Partnership Agreement, which states "By 2005, 99 percent of the population served by public water supply systems will have water that meets Safe Drinking Water Standards."

B. Programmatic Changes

Beginning May 12, 2003, Mr. James McGoff became Executive Director for the DWSRF and Wastewater SRF Programs. The newly-created Executive Director position is to further assist the SRF Programs to operate as one unit rather than as two programs operated by two separate departments of state government. The ultimate goal is to have the Department and Budget Agency's staff housed together in one location to create a fully-integrated "SRF Program" rather than two separate agencies managing different parts of the Program. The Program will also begin corresponding and marketing itself as the "SRF Program," rather than as the Department and Budget Agency.

Mr. McGoff comes to the SRF Program from Bingham McHale, an Indianapolis-based law firm. He joined Bingham McHale in 1991 after graduating from the Indiana University School of Law. He became a partner in 1999 and has practiced primarily in the public finance and government services practice groups. He also has served as bond counsel, underwriter's counsel, issuer's counsel and trustee counsel for a broad range of tax-exempt financings on behalf of the state of Indiana, as well as various Indiana cities, towns, library districts and school districts.

C. Financial Status of the Fund

Introduction. Federal funds (EPA capitalization grants), leveraged funds (Guarantee Revenue Bond proceeds) and State funds (State Match Revenue Bond proceeds) are used to capitalize the DWSRF Program. The majority of the bond proceeds are, in turn, loaned to Participants for eligible projects. The DWSRF Program receives its Capitalization Grants to serve as "security" for Guarantee Revenue Bonds issued by the State Issuer and loaned to Participants. Earnings on the Capitalization Grant serves as a "source of payment" for Guarantee Revenue Bonds and State Match Revenue Bonds issued by the State Issuer.

By the commencement of SFY 2004, the State expects to have closed loans aggregating approximately \$166 million. Many of these loans will only be partially drawn at the start of SFY 2004,

and the State expects that DWSRF funds will continue to be drawn to fund the projects associated with these closed loans.

In addition to the funding needs of closed loans, the State expects to continue making DWSRF financing available for new projects, as DWSRF resources are available.

Loan Dollars Available. During SFY 2004, the State intends to provide funds to continue meeting existing loan commitments and to make additional loans for new projects by causing additional Guarantee Revenue Bonds and State Match Bonds to be issued by the State Issuer. The issuance of these bonds will occur as, when and in amounts that are necessary for the State to meet the cash flow borrowing needs of existing and new loans. Binding commitments are only made from the DWSRF if and when a financial assistance agreement is entered into with a Participant.

By leveraging grants awarded for FFY 1997 through 2003 (together with grants the State expects to seek and be awarded in SFY 2004 related to FFY 2004 funding) under the financing structure the State utilizes, the State estimates that it could, in aggregate, generate loanable funds sufficient to fund existing closed loan commitments and those necessary to meet the demand on the Comprehensive Project Priority List. Future grants beyond FFY 2004 may also afford the State additional resources to meet loan demand in excess of such amount but that would be after SFY 2004.

The maximum amount of funding ultimately available for loans will depend on the following:

- Demand for the DWSRF Program as evidenced by Proposed Drinking Water Projects;
- The readiness-to-proceed on the part of those projects as evidenced by completion of a PER and other steps necessary to securing a program loan within SFY 2004; and
- The capacity of the DWSRF to issue additional Guarantee Revenue Bonds and State Match Revenue Bonds to generate additional loanable funds, which requires sufficient cash flows to repay them (including earnings on the funds securing them -- primarily being Capitalization Grants including the yet-to-be awarded FFY 2004 grant -- and existing and new loan repayments).

During SFY 2004, through additional bond issues, the State expects to meet the needs of Participants in the SRF Program that will be in a position to close loans during SFY 2004. However, if the Budget Agency were to later determine that some projects requesting loan assistance might not receive assistance during SFY 2004 due to limits on the lending capacity of the DWSRF, then steps would be taken to prioritize how assistance would be rendered. To address that circumstance, the State would do the following:

- Continuously assess the capacity of the DWSRF to issue additional Guarantee Revenue Bonds and State Match Revenue Bonds and issue such bonds to the extent fiscally prudent.
- Until December 31, 2003, focus loan closings on those Proposed Drinking Water Projects that are within a Fundable Range as then established and subject to the Bypass Process as addressed in more detail in Section VII below captioned "*Projects to be Assisted.*"
- After December 31, 2003, undertake loan closings for Proposed Drinking Water Projects that are outside any such Fundable Range consistent with the readiness-to-proceed and priority criteria set out in the Bypass Process.

The State's DWSRF Program is an established and highly rated borrower in the national bond market and has issued Revenue Bonds to finance the DWSRF Program. These bond issues have provided the needed state match funding, and have included approximately \$169 million for loans. By the beginning of SFY 2004, the State expects that, when fully disbursed, aggregate loans made will be approximately \$166 million. (The foregoing estimate reflects a certain volume of loan closings during the remainder of SFY 2003 and if not made, such loans would then be expected to be closed in SFY 2004 subject to the constraints of any Fundable Range and consistent with the Bypass Process to the extent the implementation of such tools became necessary.) As of the commencement of SFY 2004, the level of loan commitments is not expected to exceed loanable bond proceeds presently on-hand in the DWSRF ("Excess Commitments"). Future bond issuances are generally expected to be used to fund any Excess Commitments together with new commitments related to new loans in SFY 2003. The balance of the bond proceeds, not available for loans, are used for reserve funds, administrative expenses, costs of issuance, etc.

VI. Criteria for Methods Used to Distribute Funds

A. Allocation of Available Funds

The SDWA permits the State to use a DWSRF Capitalization Grant for a variety of purposes that protect drinking water. In addition to making loans for the construction of drinking water supply, treatment and distribution systems, the State may use the Capitalization Grant to: support activities in the Department's Drinking Water Program; provide technical assistance; improve the capability of drinking water systems; develop programs to protect sources of drinking water; and even subsidize loans or transfer funds to the Wastewater SRF. Allocating the Capitalization Grant funds between construction loans and the other activities (known as "set-asides") is among the most important decisions the State must make when preparing the IUP. (See Section VIII. captioned "*Set-Asides*" below.)

In accordance with the Memorandum of Understanding between the State Budget Agency and IDEM, the amount of the Capitalization Grant allocated to the Set Aside program will be 2% for Technical Assistance and 9% for Program Management Activities, with the total not exceeding \$1 million. IDEM will utilize the full Technical Assistance Set-Aside amount of \$187,964. IDEM will use \$75,000 of the Wellhead Protection Set-Aside. IDEM will use the Program Set-Aside for the remaining \$737,036. The funding will be spent or encumbered over a one-year period. All of the resources will be directed towards activities necessary to maintain primacy for implementation of the Safe Drinking Water Act in Indiana. After the Capitalization Grant Amount is approved, the Department will administer the DWSRF Program's Set-Asides. Any contracts funded by Set Aside dollars will be approved through the usual contract process.

Banking of funds will be used as the mechanism to balance these funding needs. If set-aside activities progress to the stage of an actual commitment or expenditure of funds, then this banking of funds will effectively become permanent. On the other hand, if set-aside activities do not progress to the stage of an actual commitment or expenditure of funds in SFY 2003, then the prior banked funds will be re-allocated to help meet the large demand for loans. At the same time, future grants expected to be awarded in the upcoming SFY will be looked to for reserving funds for uncompleted or additional set-aside activities. Uncommitted "banked" funds where no progress on set-asides activities is demonstrated will be used to provide loans to participants. Future grant resources (and the banking of those funds) will

be available to provide the resources to meet those set-asides activities that are delayed. The foregoing banking of resources as described above is referred to in the Section VIII. captioned "*Set-Asides*" below as a "banked" set-aside.

The State plans to use the balance of the Capitalization Grant and the 20% state match to provide low-interest loans to eligible entities for Proposed Drinking Water Projects in the manner discussed at Section V. B. captioned "*Financial Status of the Fund*" above.

B. Transfers to the DWSRF From the Wastewater SRF

In past Intended Use Plans, the State retained the flexibility to permit transfers between the DWSRF and the Wastewater SRF of grants (and other funds) held in or allocable to such funds to the extent permitted by the Clean Water Act and the Safe Drinking Water Act. Historically, up to 33% of the amount of each Safe Drinking Water Act grant for FFY's 1997 through 2002 could be so transferred on a net cumulative basis, which meant that flexibility existed to re-transfer funds back to the Wastewater SRF from the DWSRF and visa versa until October 1, 2002. Based on the State's award of Safe Drinking Water Act related funds for FFY 1997 through 2002, as of October 1, 2002, approximately \$23.7 million has been transferred to the DWSRF from the Wastewater SRF; under present law this transfer has become permanent.

In the event of changes in the Safe Drinking Water Act, the State retains the flexibility to make transfers from the Wastewater SRF and the DWSRF in SFY 2004. The State expects that cumulative DWSRF loans in SFY 2004 would be at or near its lending leverage capacity (and expects the Wastewater SRF in SFY 2004 will not be constrained on a relative basis) and thereby creates this opportunity. Subject to the Safe Drinking Water Act, any such transfers would be at times and in amounts determined by the Budget Agency to be most beneficial to the programs.

Each transfer would only be made between accounts established for like purposes (and subject to like restrictions) in the Wastewater SRF and the DWSRF and will be accounted for on a cumulative net basis. Consistent with prior transfers, the State would expect that transfers would be from funds held in its Restricted Subaccount of the Equity Fund (or other funds held in the SRF) and that such funds would be used to facilitate generating additional lending capacity under the leverage loan structure of the DWSRF. The State would not expect such transfers (which, if changes are made to the Safe Drinking Water Act to allow it, would be expected to be in the amount of 33% of its FFY 2004 grant, or about \$3 million) to have a material impact on the capacity of the Wastewater SRF to finance proposed projects during SFY 2004. Notwithstanding the foregoing but subject to the Safe Drinking Water Act, the State retains the flexibility to transfer undrawn Wastewater SRF grants and/or to fund direct DWSRF loans with transfers.

The State would expect to only make transfers as and to the extent that such could be done in a manner consistent with agreements related to outstanding Guarantee Revenue Bonds and State Match Revenue Bonds.

C. Loan Rates and Terms

The Budget Agency recognizes the continued need to balance the level of subsidy (that is, the cost of offering loans at below-market interest rates) with the inherent limited capacity of the DWSRF to meet demand for loans and community affordability constraints. This balancing is

reflected in the State's present interest rate policy, which subject to future change, if any, is reflected below.

The State now uses a fixed rate scale, which varies based on three ranges of average monthly user rates for an equivalent dwelling unit (User Rates) within each of the three previously existing Median Household Income (MHI) Tiers, to set DWSRF Program interest rates. The User Rates used in determining DWSRF interest rates are inclusive of the SRF Program loan. This results in nine possible DWSRF Program interest rates -- see the below Chart. Lower rates are targeted to Participants with lower MHIs and/or those with higher User Rates.

<i>DWSRF -- Interest Rate</i>	<i>User Rates (Over \$45)</i>	<i>User Rates (\$25 to \$45)</i>	<i>User Rates (Under \$25)</i>
Tier III (MHI: under \$33,254)	2.9%	3.1%	3.3%
Tier II (MHI: \$33,254 to \$41,567)	3.6%	3.8%	4.0%
Tier I (MHI: over \$41,567)	4.1%	4.3%	4.5%

* MHI based on 2000 census data.

User Rate information is reviewed by the Budget Agency for use in finalizing an DWSRF Program interest rate. Participants are asked to have their local rate consultant complete this before a rate ordinance is adopted at the local level.

In the past when Participants had outstanding debt, they often wrapped new DWSRF debt service around the old debt so that aggregate debt service was level. Now, wrap DWSRF loans with over a 14-year weighted average principal maturity are charged 20 additional basis points to help offset the additional subsidy they afford. The Budget Agency will have discretion to waive the extra charge for Participants in the lowest MHI range that are in the highest User Rate category. Additionally, any Participant proposing to use a wrap structure will be required to justify it (including showing a substantial effect on User Rates) before it can be used.

The State's current policy is that non-Political Subdivisions will receive loans at a rate that is no lower than a Political Subdivision's DWSRF Program rate as expressed above. However, the Budget Agency in consultation with IDEM may determine "what is necessary" to make such a project viable and thereby charge a higher interest rate than what would be available for a DWSRF loan to a Political Subdivision.

The foregoing is the State's present interest rate policy. The Budget Agency expects to monitor DWSRF Program interest rate adjustments as appropriate. Adjustments to this rate structure may be made from time to time, but will not affect loans closed prior to the adjustment. The foregoing does not commit the State to make new loans on that basis.

As with all DWSRF Program loans closed to date, the State acknowledges that all future DWSRF loans will be made at rates at or below those prevailing in the market.

Terms. Consistent with applicable law, all SRF loans will be structured so that there are at least annual principal repayments (commencing one year after expected completion of the project) and a final principal payment no later than 20 years after expected completion of the project. Additionally, the State expects debt service payments to be approximately equal in each year the loan is outstanding (except in

certain limited circumstances, such as where DWSRF Program debt service is wrapped around existing debt and is justified on user rate affordability basis). The making of a DWSRF Program loan on any basis other than level, aggregate annual debt service is subject to additional State review and approval.

Cross-collateralization of the Wastewater SRF with the Drinking Water SRF. To the extent permitted by the Clean Water Act and the SDWA (each as supplemented by applicable federal law), the State has cross-collateralized the Wastewater SRF and the DWSRF to optimize the capitalization requirements of each program and better manage the specific funding needs of projects assisted through them.

This cross-collateralization arrangement maximizes the security for bonds issued by the State Issuer to capitalize either the Wastewater SRF Program or the DWSRF Program. Accordingly, this could relate to and affect all types of funds held in the Wastewater SRF and the Drinking Water SRF. The State would expect that any such transfers would occur at any time necessary to prevent a default on any such bonds and would be made between accounts established for like purposes (and subject to like restrictions). To date, no transfers of this nature have been made.

The State would expect to retain the flexibility to reimburse (on a cumulative net basis) any transfers made under a cross-collateralization arrangement. Because such a cross-collateralization arrangement is a contingent security concept and transfers are not expected or planned to occur, the State would not expect this to negatively affect the funding capacity of either the Wastewater SRF or the DWSRF. However, if such transfers occur and are not reimbursed, it may affect the burdened fund's ability to make some volume of additional loans it otherwise might have been able to make.

VII. Projects to be Assisted

A. Projects Expected to Receive Loans

In *Appendix B*, the Project Priority List ranks the Proposed Drinking Water Projects for which the Department received applications by March 7, 2003. The systems -- along with a description of each project's plans, the expected amount of assistance and system size -- are listed in priority order.

As stated in the IUP, the State employs a leveraged financing structure to maximize the amount of funds that the DWSRF can lend. The capacity of this structure is not capable of precise advanced prediction but is subject to limits in the commitments that the DWSRF can make. Future funding capacity can vary materially if there are changes in the calculating assumptions including, among others, future loan rates; future interest rates on Guarantee Revenue Bonds and State Match Revenue Bonds; the rate at which Capitalization Grants are converted to cash; the amount of future Capitalization Grants; and future investment rates.

The Budget Agency will manage requests for financial assistance consistent with its projections of the funding capacity of the DWSRF and the practices and information described under the caption "*Fundable Range*" and "*Bypass Process*" below. Participants seeking assistance from the DWSRF should understand them and pursue their funding needs accordingly.

B. Fundable Range

To inform the public as to current estimates regarding the DWSRF's potential to fund projects and to direct DWSRF loan assistance in an efficient manner to the highest priorities where possible, the State has calculated a "Fundable Range" and will use it to allocate those resources. As of the commencement of SFY 2004, the Budget Agency believes that with the award of SFY 2004 grant to continue to capitalize the SRF, demand for DWSRF assistance will be met and the Fundable Range concept will not be applicable during SFY 2004.

The Fundable Range represents an assumed amount of DWSRF loans that could be made under various assumptions using current loan capacity estimates. Overlaying the Fundable Range over the Comprehensive Project Priority List estimates the aggregate amount of loans that can be made if those projects close their requested loans under present assumptions. Based on current estimates and assumptions, all projects listed on the PPL expected to close in SFY 2004 could be funded through DWSRF loans within this estimated funding capacity.

It is vital to understand that the Fundable Range is one tool used to assist the State in planning and prioritizing its work and resources. If during SFY 2004 the Budget Agency were to determine that funds available were insufficient to fund all projects on the Comprehensive Project Priority List, then the Fundable Range concept would be implemented. In such a circumstance, Projects within the Fundable Range will be afforded a priority of resources, most notably: (1) an ability to close as soon as the necessary programmatic and financial steps are taken to complete their loans, and (2) priority of State resources to help those Participants complete the required programmatic and financial steps. However, actual funding of each DWSRF loan will continue to require each applicant seeking a loan to diligently pursue the programmatic and financial steps necessary to consummate a loan in a timely manner. Each Participant is ultimately responsible for completing these steps.

Accordingly, being within the Fundable Range would effectively give preference to those projects to complete their required programmatic and financial steps. This preference is not an exemption from programmatic and financial requirements. However, being within the Fundable Range would afford greater predictability as to the availability of funds within the funding capacity limits of the DWSRF.

If established, Proposed Drinking Water Projects within any such Fundable Range would be encouraged to immediately take the programmatic and financial steps necessary to complete their loan by December 31, 2003 because only projects in the Fundable Range would be permitted to close an SRF loan by January 1, 2004. For projects in the Fundable Range that have PERs approved, this preference is only afforded for a 90-day period.

If established, Proposed Drinking Water Projects outside any such Fundable Range (i.e., those lower on the priority list) would also be encouraged to take the steps necessary to be in a position to be eligible for completing their desired loans by January 1, 2004 (or as soon as practical thereafter) because those projects that have completed their programmatic and financial steps by January 1, 2004 may well be afforded the opportunity to do so under the described Bypass Process below. DWSRF's experience has shown that many higher ranked projects fail to take the steps necessary to complete programmatic and financial steps to close a DWSRF loan in a timely manner (or even by the end of the SFY for which funding was requested). For this reason, all applicants are encouraged to continue through the DWSRF process. Those projects not funded in SFY 2004 would be eligible to carry forward efforts to seek funding in the next SFY.

Communities are advised that early submission of a PER to IDEM and steadfast diligence in pursuing a PER through the DWSRF Program approval processes is essential in order to complete the preconditions to close a DWSRF loan. Any community initially determined to be within the Fundable Range, which does not have a PER submitted to IDEM by July 31, 2003 will be bypassed. Even when a higher priority project is involved, submission of a PER after July 31 simply does not allow sufficient time to complete the PER processes and close an SRF loan by January 1, 2004, which is the goal for each project determined to be within the Fundable Range.

C. Bypass Process

Consistent with 40 CFR § 35.3555(b)(2)(ii), if during SFY 2004 the Budget Agency were to determine that funds available were insufficient to fund all projects on the Comprehensive Project Priority List, then the State will use the following bypass procedures to allow other projects on the Comprehensive Project Priority List to receive financial assistance from the DWSRF during SFY 2004. These bypassing procedures enable projects originally identified outside the Fundable Range to be funded when higher-priority projects have not yet progressed to a stage allowing for loan closing. However, if a bypassed project becomes ready to proceed, they will have funding priority over other projects below it on the PPL. To this end, if during SFY 2004 the Budget Agency were to determine that funds available were insufficient to fund all projects on the Comprehensive Project Priority List, the following Bypass Process would be used in SFY 2004:

1. IDEM will rank Proposed Drinking Water Projects on the PPL.
2. The Budget Agency would designate a Fundable Range by notice to all Applicants with projects on the PPL, which after established, may be reduced or increased by the Budget Agency if warranted during SFY 2004. This will be determined by comparing the capacity shown in cash flow modeling to the project amounts on the PPL subject to other known adjustments. Participants are advised that being in the Fundable Range does not mean that a loan commitment is made (or funding is guaranteed or reserved); rather it means funding priority will be given to those Proposed Drinking Water Projects. Additionally, others may still receive funding (or future priority) if they are ready to proceed.
3. The Budget Agency will bypass projects on the Fundable Range that have not submitted PERs by July 31, 2003. The Budget Agency would extend the Fundable Range by the amount of such bypassed projects. This is intended to afford Participants nearly within the original Fundable Range to gain priority in working to quickly close their loans.
4. The Budget Agency will bypass projects on the Fundable Range that have PERs approved but their loan is not closed (or scheduled to close) within 3 months after the establishment of a Fundable Range. (This bypass procedure will not apply to new systems unless construction bids have been received because new systems are not permitted to close their DWSRF Program loans until after bids are received rather than after PER approval.) The Budget Agency would extend the Fundable Range by the amount of such bypassed projects. This is intended to afford Participants nearly within the original Fundable Range to gain priority in working to quickly close their loans.

5. Until January 1, 2004, only projects in the Fundable Range would be permitted to close a DWSRF loan.
6. On and after January 1, 2004, any project ready to close a DWSRF Program loan under applicable DWSRF Program lending requirements would be permitted to do so. If the Budget Agency determines there is not sufficient lending capacity, then the highest-ranked loans at a ready-to-close stage would be closed first.
7. Drinking Water Projects that are necessary to alleviate unanticipated catastrophic or emergency situations that pose a threat to public health may be elevated to the top of the Project Priority List upon the recommendation of the Department's Office of Water Quality. Emergency projects would include, but not be limited to, the loss of safe drinking water resulting from the following events: flood, fire, system collapse, tornado, weather damage or hazardous spills. Such emergency projects will be added to the top of the Project Priority List for immediate assistance. One or more projects in the original Fundable Range may be moved out of the Fundable Range in order to provide loans to emergency projects.
8. All unfunded projects are eligible to remain on the next SFY's PPL if they inform the Department of their desire to do so.

D. SRF Entity Eligibility

All Public Water Systems are eligible to apply.

E. New Applications

The Department continues to accept applications for Proposed Drinking Water Projects after the March 7, 2003 deadline. The Department may score new projects and re-rank at least twice in the State Fiscal Year. See *Appendix A* for ranking and scoring procedures.

F. 120-Day PER Submission Policy

In an effort to move projects more quickly through the DWSRF Program review and approval process, the Department will continue enforcing a 120-day, post PrePlanning Meeting PER submission policy for all projects within the Fundable Range. All DWSRF Program Applicants will have up to 120 days after their Preplanning Meeting with the Department and the Budget Agency to submit a completed copy of their PER to the Department. The Department will continue tracking all projects to ensure that all the respective PERs are submitted within the required time frame. If an Applicant does not submit a completed PER to the Department within 120 days of their Preplanning Meeting, their project may be removed from the PPL at the discretion of the Department.

G. Requirements for Loan Closing

The State expects to continue requiring each DWSRF-eligible entity to establish a dedicated source of payment for all loans made from the DWSRF and cause such loans to be paid according to their terms. The State will generally expect each loan to be evidenced by bonds (or other evidence of indebtedness) issued by or on behalf of the Participant. This will generally require each Participant to complete the following steps prior to a loan closing:

- Submit financial and operating information acceptable to the Budget Agency to evidence the establishment of a dedicated source of payment and an ability to pay each loan according to its terms;
- Complete required notices, hearings and other local actions to issue bonds (or other evidence of indebtedness) in a form and substance acceptable to the Budget Agency;
- Complete required approvals, if any, of the Indiana Utility Regulatory Commission;
- Issue bonds (or other evidence of indebtedness) in a form and substance acceptable to the Budget Agency, together with opinions of nationally-recognized bond counsels to the effect that such are valid and binding obligations under State law, and except in very limited circumstances, interest thereon is excludible from gross income for federal tax purposes; and
- Enter into a financial assistance agreement with the State in the form proposed by the Budget Agency.

The State will expect DWSRF-eligible entities to engage a nationally recognized bond counsel and a qualified financial and rate consultant at its own expense to assist in structuring each DWSRF Program loan and its dedicated source of payment. These costs may be paid from DWSRF loan proceeds.

In addition to the foregoing requirements, the State has determined that the lending requirements for DWSRF Program loans made to non-profit and for-profits entities will be different from those used for Political Subdivisions. To date, only a limited number of such loans have been closed. As more DWSRF Program loans are made to non-profit and for-profits entities, these requirements will be continue to be refined to assure the purposes of the DWSRF Program are furthered in a fiscally prudent manner. Additionally, because the DWSRF Program funds financial assistance from Guarantee Revenue Bonds, and State Match Revenue Bonds issued by the State Issuer and the nature of those bonds significantly limit the aggregate amount of loan assistance that can be made to non-governmental units, DWSRF Program loans will only be made to non-profit and for-profit entities in conformity with those limits. Once the combined aggregate amount of loan assistance to non-profit and for-profit entities funded from any single bond issue reaches the lesser of \$5 million or 5% of bond proceeds ("Private Funding Bond Limit"), no further loans will be made to any non-profit and for-profit entity from that bond issue. Unless additional Guarantee Revenue Bonds and State Match Revenue Bonds are issued by the State Issuer during SFY 2004 or other sources of permissive funding are found to be available, the Private Funding Bond Limit is a constraining factor in funding this category of Participants. As of this date, no determination has been made as to whether other sources of permissive funding will be available, or if available, how much it will be.

H. Public Health Focus

As administrators of the DWSRF Program, the Department and Budget Agency will put forth every effort to work with and give priority to those Applicants with a greater public health need. The scoring system, which places greater emphasis on public health issues, is described in *Appendix A*.

VIII. Set-Asides

A. Use of Set Asides

The 1996 Amendments to the Safe Drinking Water Act authorized States to provide funding for certain set-aside activities. The use of the set-aside funds is a key element in the Office of Water Quality's strategy to achieve the agency's priority of "Focus on Water Quality." The funding amount available can be seen in Section VI. A. "*Allocation of Available Funds*" above.

IDEM will utilize the FY 2003 DWSRF Set-Aside allotment to implement the requirements of the Safe Drinking Water Act (SDWA). The funding amount available is \$1,000,000, based on the Memorandum of Understanding (MOU) between the Department and the Budget Agency. IDEM will utilize the full Technical Assistance Set-Aside amount of \$187,964. IDEM will use \$75,000 of the Wellhead Protection Set-Aside. IDEM will use the Program Set-Aside for the remaining \$737,036. For further explanation of how these Set-Asides will be utilized, please refer to *Appendix C*.

IX. Capacity Development

A. New System Capacity

The State is currently implementing the "Program Implementation Plan for Capacity Development for New Public Water Supplies" that was approved by EPA Region V on August 20, 1999. The plan requires the demonstration of technical, managerial and financial capacity by every new community water system and new nontransient noncommunity water system. According to EPA's July 1998 "Guidance on Implementing the Capacity Development Provisions of the Safe Drinking Water Act Amendments of 1996," a State must provide a report of the ongoing implementation of a capacity development program for new systems. Withholding decisions for the FFY 2003 capitalization grant are based on the status of the capacity development program for new systems as of October 1, 2002. On October 22, 2002, the State submitted the "New System Capacity Development Program Annual Summary Report" to EPA Region V ("the Region"). The report provided a summary of program implementation methods and statistics from October 1, 2001 through September 30, 2002, as requested by the Region. As a result, the State has met the requirement of Section 1420(a) of the Safe Drinking Water Act (SDWA) and is eligible to receive its allotment for the DWSRF capitalization grant with respect to the capacity development requirement for new public water supplies.

B. Existing System Capacity

According to Section 1420(c) of the SDWA, a state must be developing and implementing a strategy to assist existing public water systems in acquiring and maintaining technical, managerial and financial capacity. Development and implementation of the strategy was required by August 6, 2000 in order to avoid a withholding of ten percent (10%) of the FFY 2001 DWSRF capitalization grant. On July 28, 2000, Indiana submitted the final draft of the "Capacity Development Strategy for Existing Public Water Systems" to EPA Region V. The Region approved the strategy on September 14, 2000. On October 22, 2002, the State submitted the second "Existing System - Capacity Development Strategy Implementation Annual Summary Report" to EPA Region V. The report provided a summary of program implementation methods from October 1, 2001 through September 30, 2002, as requested by the Region.

As a result, the State has met the requirement of Section 1420(c) of the SDWA and is eligible to receive its allotment for the DWSRF capitalization grant with respect to the capacity development requirement for existing public water supplies.

C. Assessing Capacity of DWSRF Loan Applicants

Per Section 1452(a)(3) of the SDWA, any public water supply applying for a DWSRF Program loan must have the technical, managerial and financial capacity to operate, unless the financial assistance will ensure compliance with the regulations and address any capacity inadequacies. The State will utilize existing information to assess the capacity of a public water supply that applies for a DWSRF Program loan.

- Technical:* IDEM will review the compliance status of the Applicant with regards to the provisions of the State's Drinking Water rules and regulations and the SDWA. For example, the system must meet the public water system quantity requirements to ensure a safe, adequate water supply. The analytical results of bacteriological and chemical sampling will be reviewed to ensure that the finished water meets the drinking water standards and will be used to assess potential problems with source water. For groundwater systems, an evaluation of compliance with the Indiana Wellhead Protection Rule will also be used to assess the source water protection efforts of the system. The most recent sanitary survey of the system will be reviewed to assess the adequacy of the infrastructure and the condition of the system and its components. A review of compliance with the current applicable operator certification requirements and onsite evaluation during surveys will be used to evaluate the technical knowledge of the operator of the eligible system.
- Financial:* To review the financial capacity of a Public Water System, the Budget Agency will review the information described in Section IV C captioned "*Requirements for Loan Closing*" above. Such information must generally evidence the establishment of a dedicated source of payment and an ability to pay each loan according to its terms
- Managerial:* IDEM will review the Public Water System's compliance with the current applicable operator certification requirements.

For SFY 2004, the State will also request that DWSRF Applicants complete a capacity development self-assessment form. The form includes a comprehensive set of questions regarding the technical, managerial and financial capacity of public water systems seeking DWSRF Program assistance. If a Public Water System does not have adequate technical, financial and managerial capacity and the financial assistance requested through DWSRF will not directly provide the resources to meet the capacity criteria, the public water supply must submit a plan describing the steps they will take to ensure adequate capacity in order to be eligible for DWSRF Program assistance. IDEM staff will continue to provide technical assistance to the Public Water System as needed to assist in developing the plan to meet the capacity requirements.

X. Public Review

A. Public Hearing

A public hearing on the proposed SFY 2004 DWSRF Intended Use Plan was held at 2:00 p.m. on June 17, 2003, at the Marion County Public Library, 2822 E. Washington St., Indianapolis. Public notice of the hearing date and time was given in several newspapers published across the State, no later than June 3, 2002. Copies of this proposed Intended Use Plan and Priority Ranking System were sent to all Participants with projects listed on the Project Priority List and other interested persons, and was deposited in the Department's Indianapolis, Northern, Northwest and Southwest Indiana offices and in 14 Indiana public libraries. Copies were also available upon request. In addition to the public hearing, written comments were accepted until June 28, 2002.

B. Records

All documents received and prepared in connection with Proposed Drinking Water Projects will be filed appropriately and maintained by the State in accordance with State Law. These documents will be available to the public (in accordance with the State Access to Public Records Law, IC 5-14-3-1 et seq.) and EPA.

APPENDICES

- APPENDIX A: INDIANA'S SCORING AND RANKING SYSTEM
- APPENDIX B: INDIANA'S PROJECT PRIORITY LIST (PPL)
- APPENDIX C: INDIANA'S SFY 2003 SET-ASIDE WORK PLAN

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